State Dept. review completed

Page Denied

STAT

[redacted] 25X1

216

Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

3 December 1985

South Korea: Ready To Deal on Trade Issues? [redacted] 25X1

Summary

After four months of fanning the public outcries against US pressure for market opening measures, Seoul has signaled its willingness to settle specific trade disputes now on the table--access to the Korean insurance market and protection of intellectual property rights. Even so, we expect progress on these and other outstanding trade issues will be slow, in part because Seoul is likely to compromise only when it is convinced that Washington is ready to apply stern trade sanctions. In light of the recent slowdown in South Korea's growth, domestic economic and political pressures also will shape Seoul's response to US trade action in a variety of target areas in the coming months. Seoul would probably find it easiest to deal with US initiatives aimed at the exports of large

25X1

This memorandum was prepared by [redacted] Office of East Asian Analysis. Information available as of 2 December 1985 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Korea Branch, Northeast Asia Division, OEA, on [redacted]

25X1

25X1

EAM 85-10212

[redacted] [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

conglomerates--the government already favors a policy to limit their power. US action against the products of such politically sensitive and beleaguered sectors as agriculture, textiles, footwear, and small- and medium-sized industries would pose far greater difficulties for the South Koreans and could sour the prospects for future bilateral negotiations on trade issues. [redacted] 25X1

Confrontation Giving Way to Compromise?

Seoul's bitter reaction to Washington's efforts to open South Korea's markets peaked last month when Washington announced the imposition of large antidumping duties on photo albums. By not discouraging strident rhetoric, Seoul gave the green light to the press to exploit popular discontent with the United States. Moreover, Chun tried to use the highly visible public reaction to put the onus for economic reform on Washington and to deflect domestic criticism of his handling of a slumping economy and political tensions. [redacted] 25X1

Resentment in Seoul over Washington's call for market opening measures now seems to be giving way to a new, albeit tentative, commitment to resolving pending trade issues:

[redacted] 25X1

-- Over the past month, we have seen a series of apparently government-encouraged media roundtables and press editorials designed to give a more balanced picture of US-Korean trade relations.

-- Kim Ki-hwan, Seoul's point man on international economic issues, has proposed prompt, quiet bilateral talks to resolve pending insurance and intellectual property rights disputes. According to Kim, Chun has said he recognizes that additional trade actions would be a disaster for South Korea and that Seoul must negotiate.

-- Public remarks by Chun and some top advisers seem calculated to prepare government and business leaders, as well as the general population, for compromise on trade issues. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Nonetheless, we believe progress will come only after hard-nosed negotiations. We have seen no evidence the South Koreans will abandon their pattern of trying to put the best light on proposals they have already formulated--proposals they know fall far short in key areas of concern to Washington. Seoul may calculate that US attention to trade issues will decline once the 1986 Congressional elections are over and that delaying tactics will enable South Korea to wait out the furor. [redacted] 25X1

Moreover, Seoul's efforts to foment anti-US reaction on trade issues may have reduced its room for compromise:

-- Violent student demonstrations have increasingly featured anti-American themes. The takeover of the American Chamber of Commerce in Seoul on 4 November and the USIS center in Kwangju City on 2 December included verbal attacks on South Korean dependence on the United States and on Washington's call for market opening.

-- If Chun reverses his hard stance now in favor of compromise on insurance, intellectual property, and import liberalization, the radical students and perhaps some of his more moderate critics will accuse him of giving in to US pressure. [redacted] 25X1

Finally, senior economic officials in Seoul apparently believe that South Korea may still be able to avoid stern US trade actions because of its "special" relationship with the United States. In fact, South Korean officials have muddied the waters in their own policy discussions regarding the "linkage" between security and economic relations with the United States. 25X1

[redacted]

In sum, we do not rule out the possibility that Seoul might make one or two bold gestures that could quickly close the books on insurance and intellectual property rights issues. We believe it is more likely, however, that South Korean negotiators will take an incremental approach, carefully weighing Washington's response at each turn, in the hope of giving up as little as possible. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Seoul's Likely Response to Additional Trade Measures

In our view, South Korea is bracing for additional US trade action, partly because it expects its planned response on the insurance and intellectual property rights cases may fall far short of US demands. In addition, the surprise action on the photo album case taught the South Koreans that US trade measures may not necessarily be keyed to Seoul's responsiveness on the two pending 301 cases. On the basis of South Korea's track record in the past, we judge there is likely to be a range of reactions to new moves by Washington (see the appendix). In some cases, bureaucratic realities will shape the speed and response to selected US trade actions. In others, political factors will weigh more heavily. [redacted] 25X1

Straining the Bureaucratic Machinery. Consensus among Seoul's policymakers--a key to resolving current trade difficulties--is a time-consuming process involving entrenched bureaucrats, who generally oppose market opening, and the numerically weaker, US-oriented members of Chun's proliberalization economic policy team. The differences between these two groups would make a quick compromise difficult if the United States pressed for speedy resolution of the insurance and intellectual property rights cases. Chun could force acceptance of his economic advisers' views, but such snap concessions could later open him to attack from opponents of reform. [redacted] 25X1

To be sure, the limited scope of the 301 cases on the table restricts the number of interested parties. But the few players involved--mainly the large conglomerates--have important financial stakes, and their past behavior suggests they will press Seoul to engage in foot-dragging in response to US demands. The prospect of lost profits in a more open insurance industry--now a ready source of loans with "no questions asked" for cash-strapped subsidiaries--and the idea of paying for patents and copyrights that are now free are certain to worry and perhaps weaken the already beleaguered conglomerates. The government cannot afford to ignore their problems, since it is committed to covering the bad debts of the corporate sector to maintain the solvency of the commercial banks--the banks' $1.25 billion in equity is offset by bad loans worth $4.6 billion. [redacted] 25X1

Initiating additional 301s would also strain Seoul's policymaking resources, as the few qualified personnel divide their attention among new challenges. Moreover, Seoul perceives its efforts to resolve cases already on the table--no matter how modest--as sincere gestures, and there could well be a backlash against the United States if Washington takes additional trade actions while negotiations are under way. More 301s would also have political fallout, for South Koreans would again view themselves as being unfairly singled out for punishment. [redacted] 25X1

[redacted] 25X1

25X1

<u>Targeting Exports Could Hit Political Nerves</u>. Seoul probably calculates that sanctions against specific South Korean exports to the United States taken to force concessions on 301 cases would fall far short of inflicting serious economic pain.[1] We believe, therefore, that Seoul would shape its negotiating stance largely in response to the domestic political reaction--and consequent costs to the government. Retaliatory measures that target vulnerable sectors, while capturing Seoul's attention, would risk renewed sharp press reaction as well as anti-US and anti-Chun attack from radical students. The sensitive sectors include:

-- <u>Agricultural products</u>. Although agricultural goods account for only 1.5 percent of US purchases from South Korea, the rural sector remains a pivotal political constituency. An apparent failure by Chun to protect the interests of "poor farmers" would open him to widespread criticism, even from the urban population.

-- <u>Small- and medium-sized firms</u>. South Koreans would view actions against products of these firms as cases of the strong picking on the weak. A replay of the viscerally negative South Korean response to the large duties imposed on photo album producers--generally very small, labor-intensive firms--would be likely. Such US moves would also erode sympathy for Washington among proliberalizers, who want to encourage small business growth and stem industrial concentration in the large conglomerates over the long run. 25X1

Even more difficult for Seoul to deal with would be trade measures aimed at the <u>textile industry</u>. Beyond the importance of textiles as a key export--textiles accounted for 25 percent of South Korea's exports to the United States last year--the industry's health could play a crucial role in domestic political stability and in setting the overall tone of future trade negotiations.

---

[1] The General Agreement on Tariffs and Trade limits punitive actions by one country to the amount of injury it has suffered because of a partner's trade practices. Calculating the loss to US interests from South Korea's closed insurance market and lax intellectual property rights enforcement is at best an art, but Seoul has bandied about a $300 million cost to complying with US demands. 25X1

25X1

[redacted] 25X1

-- Restrictions on textile goods would hit hardest in provincial manufacturing centers--Taegu and Pusan primarily--that are already economically depressed.

-- Smaller textile manufacturers, who subcontract from the dominant firms, would disproportionately shoulder the burden of cutbacks as the larger firms pushed the pain of any drop in orders down the line.

-- Opposition to Chun's economic agenda runs particularly deep in provincial industrial centers, where economic and trade issues are of special concern. These areas, like Seoul, have been the scene of recent anti-American protest actions. [redacted] 25X1

The depth of South Korean reaction to textile-related US measures could grow considerably if there was a general perception that the Jenkins Bill--or similar bills--would become law. According to the US Consulate in Pusan, the passage of a Jenkins-like bill would cut an estimated $150 million from Pusan area textile sales and force the firing of 10,000-15,000 workers. [redacted] 25X1

Trade actions against these politically sensitive industries would encourage Seoul to make good on its threats to retaliate against the United States by switching to other sources for major imported items. Agricultural products--which accounted for $1.5 billion dollars in US exports to South Korea in 1984--would be one obvious category; energy resources would be another. So far, we have seen no evidence that South Korea plans to carry through with these threats, but it could do so--though not easily--by shifting substantial shares of grain and coal imports to other countries, such as Canada, Australia, and even China. If only half of the Korean market were lost, US producers would lose at least $800 million. [redacted] 25X1

Conglomerates--Big Bull's-Eye

We would expect more flexibility in Seoul's bargaining positions and reform program if action against Korean goods took the form of a "surgical strike" against selected exports of conglomerates. Since he came to power in 1980, Chun has allowed his economic team to limit the growth and political clout of the large firms. The current economic slowdown, however, has forced Seoul to partially abandon that policy in the hope that feeding the conglomerates' appetite for growth will spark a broad recovery. Chun could find it convenient to agree to actions against the conglomerates as a way to show them that the favorable treatment they now enjoy is only temporary, and not a return to the halcyon days of the 1970s. At the same time, he could try to saddle the United States with the blame for reforms. [redacted] 25X1

25X1

[redacted]

[redacted] 25X1

Most South Koreans recognize that some practices by the major conglomerates--such as violation of intellectual property rights--are indefensible. Trade actions targeted only at those who are guilty is unlikely to generate enmity toward Washington--or Chun. In addition, unscientific but persuasive opinion sampling suggests the average Korean distrusts the conglomerates. That distrust stems in part from the concentration of wealth in the coffers of a few, as well as periodic financial scandals and price gouging. In 1984, for instance, there was an outcry when domestic television prices were found to be higher than in the United States. Finally, focusing on conglomerates' exports could lessen their pressure on the government to protect insurance markets, since the large firms would be likely to suffer most from retaliatory sanctions. [redacted] 25X1

Targeting higher technology, capital-intensive and up-scale exports that depend on the US market for their success will probably have the best chance of convincing conglomerates to ease pressure on Seoul and endorse new regimes for insurance and intellectual property rights. Pressure points that would make the conglomerates most likely to sign up include:

-- <u>Automobiles</u>. Hyundai will inaugurate its flow of South Korean autos to the United States in January, when the low-priced "Pony Excel" goes on sale. Korean auto firms are predicating their success in the US market primarily on price competitiveness, and any tariff that closes the price gap will be seen as dimming their prospects. South Korean automakers have little alternative to the US market. The threat of automobile trade barriers would send tremors far beyond Hyundai--Daewoo and Kia already are preparing for the US market, and Samsung, which has important insurance holdings, hopes to gain government approval to produce cars as well.

-- <u>Microelectronics</u>. Samsung, Lucky Goldstar, Daewoo, and Hyundai have large investments in the semiconductor and personal computer businesses. In most cases, they have tried to leapfrog technology--for example, by moving into 64K and 256K memory chips without first mastering simpler products. Their results have been mixed and unprofitable so far, but they see success in the long run. These firms have committed their prestige as well as capital to high-technology ventures and will want to avoid sustaining losses caused by trade friction. [redacted] 25X1

Barriers to exports of less visible products produced by the large firms--such as videotape recorders--could also cause them to agree to reforms. Their responsiveness will depend on their ability to pass on the pain of sanctions to subcontractors who supply parts or other services. [redacted] 25X1

[redacted] 25X1

25X1

Outlook

In general, we believe Chun and his advisers are committed in principle to economic reform because they are concerned about their long-term access to US markets and technology and worried about the danger of wholesale barriers to Korea's exports. Legislation that would cut back exports of key goods, such as textiles, and South Korea's possible loss of the benefits from the Generalized System of Preferences--the GSP renewal process is now in progress--are an important part of Seoul's calculations. Withdrawal of even some GSP benefits would seriously impair the cost competitiveness of many South Korean export goods. It would hit small firms hard--limiting their export growth--although it would not sound a death knell for any key South Korean industries. 25X1

Moreover, Chun may have difficulty containing damage to his domestic political position if trade issues become a 'cause celebre' for his opponents. Further complicating his position is the likelihood that US restrictions on Korean exports will aggravate the current economic slowdown--which in turn could produce higher unemployment, more complaints, and the possibility of political instability. We expect him to use the threats of future harm to South Korea's exports to strengthen his hand in pressing for economic reforms as long as the domestic political cost of that response to Washington remains manageable.

25X1

25X1

Sanitized Copy Approved for Release 2010/01/25 : CIA-RDP85T01058R000202160001-5

[redacted] 25X1

APPENDIX: Section 301 of the Trade Act of 1974

Section 301 of the Trade Act of 1974 authorizes the President to take action against foreign trade practices that violate international trade agreements or burden or restrict US commerce in an unjustifiable, unreasonable or discriminatory fashion. Section 301 is intended to cover not only trade in products (goods) but also foreign practices affecting services, investment, and intellectual property rights. [redacted] 25X1

Unfair trade practices that might be appropriate for investigation under Section 301 include discriminatory rules of origin, government procurement, licensing systems, quotas, exchange controls, restrictive business practices, discriminatory taxes, standards and subsidies. [redacted] 25X1

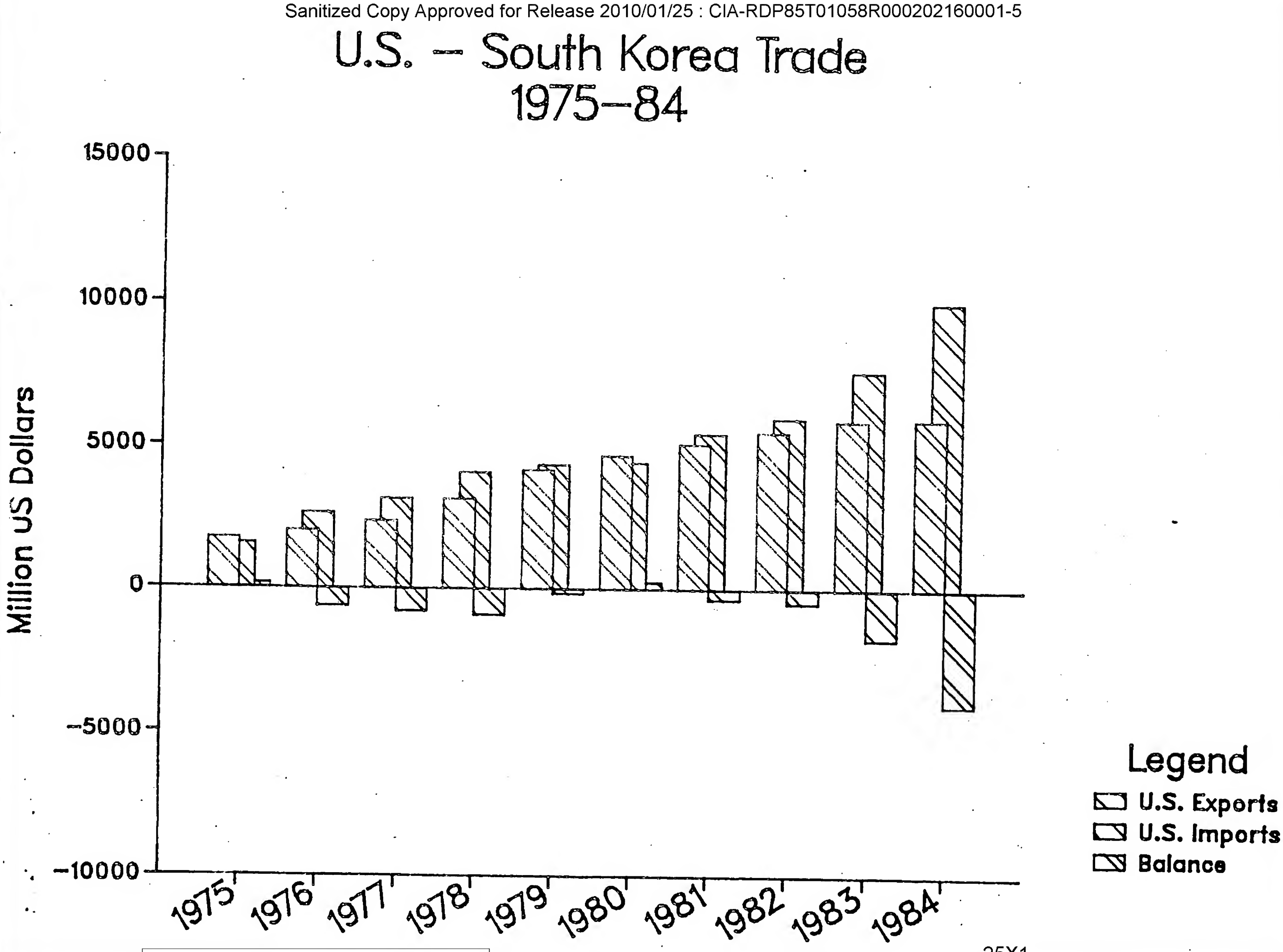
Section 301 directs the USTR to consult with the foreign country involved in the dispute as part of its investigation. This gives the foreign country the opportunity to present its views and to reach an agreement for the elimination of the disputed practice. [redacted] 25X1

Under Section 301, the President has the authority to take all appropriate and feasible actions to obtain the elimination of unfair trade practices. Specifically, he may impose duties, fees or restrictions on products and services of the foreign country involved. These restrictions do not necessarily have to be applied to, or related to, the products and services that are the subject of the 301 complaint. The President may also deny licenses issued by federal regulatory agencies to foreign service suppliers. The degree and duration of these actions is up to the President, but he will not retaliate against a country unless the 301 case adequately demonstrates that these policies are actually harming US export interests. [redacted]

25X1

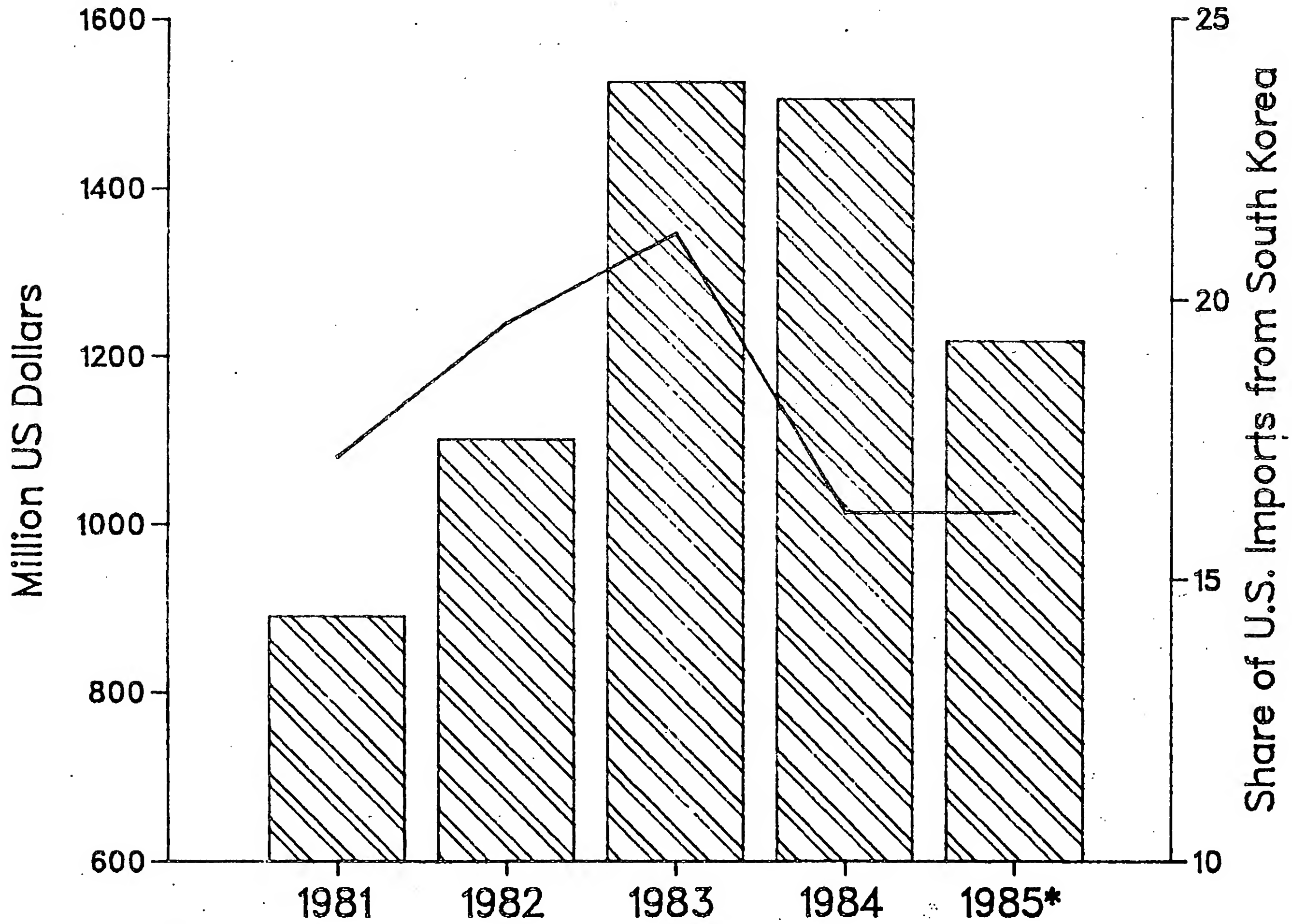
[redacted] 25X1

Sanitized Copy Approved for Release 2010/01/25 : CIA-RDP85T01058R000202160001-5


U.S. – South Korea Trade
1975–84
Million US Dollars
15000
10000
5000
0
–5000
–10000
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
Legend
U.S. Exports
U.S. Imports
Balance

25X1

U.S. Imports of South Korean Goods Under GSP 1981–85



*Through September 1985.

Sanitized Copy Approved for Release 2010/01/25 : CIA-RDP85T01058R000202160001-5

[redacted]

25X1

SUBJECT: South Korea: Ready to Deal on Trade Issues? [redacted] 25X1

Distribution:
Original - Author
1 - William Sherman, State/EAP
1 - Richard Childress, NSC
1 - Harriet Isom, State/EAP/Korea
1 - James Gagnon, State
1 - Jay Taylor, State/INR/EAP/Korea
1 - Cora Foley, State/INR
1 - Scott Goddin, Korea Desk/Commerce
1 - Byron L. Jackson, Office of Intelligence Liaison/Dept. of Commerce
1 - Peter Allgeier, USTR
1 - Sandra Kristoff, USTR
1 - Doug Mulholland, Dept. of Treasury
1 - NIO/EA (7E-62)
1 - NIO/Economics
1 - C/PPS/DO (D01)
1 - C/EA [redacted] 25X1
1 - OGI/IIC/PI
1 - OEA/NEA/Korea Branch
1 - OEA/NEA/Japan Branch
1 - OEA/NEA/STI Branch
1 - OEA/NEA Division
1 - OEA/China Division
1 - OEA/SEA Division
1 - D/OEA (4F18)
1 - C/Research/OEA
1 - FBIS Analysis Group
1 - DDI
1 - Senior Review Panel
1 - PDB Staff (7F30)
5 - CPAS/IMC/CG (7G07)
1 - CPAS/ILS (7G50)
1 - C/PES (7F24)
1 - NIC/AG (7E47)

[redacted] 25X1

25X1

OEA/NEA/KOREA/[redacted] (3 December 1985)

25X1

25X1

[redacted]